Special Session
Fiscal Note 2009 Biennium

GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Bill #	SB0001	**Title:**	Tax incentives for energy development
Primary Sponsor:	Essmann, Jeff	**Status:**	As Introduced-Revised

- [x] Significant Local Gov Impact
- [ ] Needs to be included in HB 2
- [x] Technical Concerns
- [ ] Included in the Executive Budget
- [x] Significant Long-Term Impacts
- [ ] Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Expenditures:				
General Fund	$0	$0	$0	$0
State Special Revenue	$0	$0	$0	$0
Revenue:				
General Fund	$0	$72,000	($456,400)	($456,400)
State Special Revenue	$0	$4,600	($28,700)	($28,700)
Net Impact-General Fund Balance	$0	$72,000	($456,400)	($456,400)

Description of fiscal impact:
This bill creates two new property classes, taxed at 3% and 1.5% respectively, for certain types of energy-related property and provides for a temporary abatement of property taxes on certain types of energy-related property. The net effect of these provisions will be to reduce state revenue by about $0.5 million in FY 2010 and FY 2011. This bill also provides for a reduction in the coal severance tax rates for coal to be used in certain new energy processes. This section of the bill has no fiscal impact through FY 2011.

FISCAL ANALYSIS

This bill is intended to provide incentives for investments in certain types of property. If successful, these incentives will result in additional property being constructed and taxes being collected on property that would not exist without the incentives. Tax incentives may also result in lower taxes being paid on existing property or on new property that would have been constructed without the incentives. To avoid speculation about the effects of incentives on investment decisions, the fiscal analysis section of this fiscal note examines the effects of this bill only on property that is in the development process or can reasonably be interpreted as being included in the HJR 2 property tax revenue estimates. Potential impacts of additional property that might be constructed in response to incentives are discussed in the long-range impacts section.

<u>Assumptions:</u>

Property Tax Abatement for Certain New Energy Development Property

1. Sections one through six of this bill would provide for abatement of 50% of the property taxes on property for which construction commences after June 1, 2007 and placed in service after June 30, 2007 for the purposes of carbon dioxide sequestration, renewable energy production, transmission, and transportation, coal liquefaction and gasification, clean coal research and development, and renewable energy research and development. In order to qualify for the abatement, prevailing heavy construction wage rates must be paid. The tax abatement is for 20 years after the facility commences operation. In the case of research and development facilities, the abatement begins when the research and development equipment is purchased, but may not exceed 24 years.
2. The Department of Environmental Quality (DEQ) is charged with certifying that the property qualifies for the abatement. The DEQ and the Department of Revenue (DOR) are granted rulemaking authority to administer the provisions of this act.
3. Section seven of this bill creates a new class of property, class 15, with a taxable rate of 3%. Class 15 property includes carbon dioxide pipelines, qualified liquid pipelines, carbon sequestration equipment, equipment used in closed loop enhanced oil recovery operations, and all property of pipelines, including pumping and compression equipment, carrying products other than carbon dioxide, that originate at facilities specified in 15 6 157(1), MCA, with at least 90% of the product carried by the pipeline originating at facilities specified in 15 6 157(1), MCA, and terminating at an existing pipeline.
4. Section eight of this bill creates a new class of property, class 16, with a taxable rate of 1.5%. Class 16 property includes high voltage direct current converter stations that are constructed in a location and manner so that the converter station can direct power to two different regional power grids.
5. Section nine of this bill amends 15-6-141, MCA, (class 9 property) to exclude property in the new classes of property.
6. Section ten of this bill amends 15-6-157, MCA, (class 14 property). Under current law class 14 property consists of wind generation property. This bill adds the following types of facilities to class 14: biodiesel production, biogas production, biomass gasification, coal gasification, ethanol production, geothermal, integrated gasification combined cycle, renewable energy manufacturing, natural gas combined cycle, high voltage direct current transmission lines, electric transmission lines used at least 90% for the transmission of electricity generated at facilities included in this act.
7. Information from the DEQ indicates that investment in new biodiesel and ethanol facilities that would be covered by this act will be $0.1 million in calendar year 2008, $367.9 million in calendar year 2009, and $368.1 million in calendar year 2010. The HJR 2 property tax assumptions imply growth of almost $2 billion per year of market value in the combination of class 4 and class 8. These projects are assumed to be included in the HJR 2 property tax projections. The second row shows the taxable value of these facilities under current law, assuming that 90% of the value is equipment in class 8 and 10% is real estate in class 4. The next three rows show expected state and local property taxes under current law. The next four rows show taxable value with all property of these facilities in class 14 with a 50% abatement and the resulting state and local property taxes. The last three rows show the differences in state and local property taxes due to Sections 1 through 6.

Expected Facilities Changed From Class 8 and 4 to Class 14 and Given Abatement

	2008	2009	2010
Market Value ($ million)	0.100	367.900	368.010
Taxable Value 90% Class 8 & 10% Class 4	0.003	11.041	11.044
Tax ($ million) on			
State 95 mills (general fund)	0.000	1.049	1.049
State 6 mills (university system)	0.000	0.066	0.066
Local 364 mills (statewide rural average)	0.001	4.019	4.020
Taxable Value 100% Class 14	0.003	11.037	11.040
Tax ($ million) with 50% abatement on			
State 95 mills (general fund)	0.000	0.524	0.524
State 6 mills (university system)	0.000	0.033	0.033
Local 364 mills (statewide rural average)	0.001	2.009	2.009
Difference in Tax ($ million)			
State 95 mills (general fund)	0.000	-0.525	-0.525
State 6 mills (university system)	0.000	-0.033	-0.033
Local 364 mills (statewide rural average)	-0.001	-2.010	-2.011

8. One electric transmission line that would be classified as class 14 property is expected to be built in calendar year 2008. The market value of this line is expected to be approximately $50.674 million (Draft Environmental Impact Statement for the Montana-Alberta Tie Ltd. 230-kV Transmission Line.) The HJR 2 property tax assumptions imply $66.1 million in additional market value in class 9 for calendar year 2008. Therefore, this project could reasonably be interpreted as being included in the HJR 2 projections. However, the developers of this project have stated that it will not be built in Montana if the line is taxed at the class 9 tax rate of 12%. Assuming that this is true, this bill would result in an increase in taxable value in class 14 of $0.760 million (3% x 50% x $50.674 million) beginning in calendar year 2008 and no change in class 9. Beginning in FY 2009, this would result in increased revenue of $72,000 per year (0.095 x $0.760 million) to the general fund, $4,600 per year (0.006 x $0.760 million) to the university system, and $277,000 to local governments and school districts (0.364 x $0.760 million).

Reduce Coal Severance Tax Rates

9. Section 11 of this bill amends 15-35-301, MCA, (coal severance tax rates). This section of the bill reduces the coal severance tax rate by one-half on the first 20 years of production from a new mine if at least 50% of the production is used in either a coal gasification facility or an integrated gasification combined cycle facility that sequesters carbon dioxide. This section of the bill reduces the coal severance tax rate by one-half on the first 20 years of increased production from an existing mine if the production is used in either a coal gasification facility or an integrated gasification combined cycle facility that sequesters carbon dioxide. Increased production is defined to be production in excess of the average production of the mine in the previous three years.
10. The projected number of Montana producers qualifying for exemption is zero through June 2011.
11. The projected fiscal impact of proposed law in FY 2008 through FY 2011 is zero.
12. This section of the bill applies to tax years beginning after December 31, 2007.
13. Section 15 provides that the tax incentives for new energy development apply to projects begun after May 31, 2007, and the reductions in the coal severance tax rates apply to tax years beginning after December 31, 2007.

14. The following table combines the state and local revenue impacts from the tax abatement and taxation of the Montana-Alberta Tie Line.

Summary of Revenue Impacts
Senate Bill 1 2007 Special session

	FY20008	FY20009	FY20010	FY20011
General Fund Revenue				
Tax Abatements			($525,000)	($525,000)
New Tax Revenues from Montana-Alberta Tie		$72,000	$72,000	$72,000
		$72,000	($453,000)	($453,000)
University SSR Fund Revenue				
Tax Abatements			($33,000)	($33,000)
New Tax Revenues from Montana-Alberta Tie		$4,600	$4,600	$4,600
		$4,600	($28,400)	($28,400)
Local Government Revenue				
Tax Abatements		($1,000)	($2,010,000)	($2,010,000)
New Tax Revenues from Montana-Alberta Tie		$262,800	$262,800	$262,800
		$261,800	($1,747,200)	($1,747,200)

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Fiscal Impact:				
Revenues:				
General Fund (01)	$0	$72,000	($456,400)	($456,400)
State Special Revenue (02)	$0	$4,600	($28,700)	($28,700)
TOTAL Revenues	$0	$76,600	($485,100)	($485,100)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	$0	$72,000	($456,400)	($456,400)

Effect on County or Other Local Revenues or Expenditures:

Property Tax Abatement for Certain New Energy Development Property

1. As shown in the table in assumption 14, county and other local government revenues will *increase* by about $0.26 million in FY 2009 and *decrease* by about $1.75 million per year.

Reduce Coal Severance Tax Rates

2. When the coal severance tax revenue changes, the dollars distributed 5.46% to a state special revenue account to provide basic library services for residents of all counties, and to provide for the participation costs of regional and national networking, conservation districts, and the Montana Growth Through Agriculture Act will change.
3. When the coal severance tax changes, the coal severance tax distribution of 2.90% to the oil, gas, and coal natural resource state special revenue account established in 90-6-1001, MCA will change. Under current practice, the legislature appropriates this money to the Coal Board to fund grants to local government units, state agencies, and federally recognized Indian tribes.

Long-Range Impacts:

Property Tax Abatement for Certain New Energy Development Property

1. Some energy projects whose property taxes are affected by this bill are almost certain to be built in Montana in the future. Electricity transmission projects with combined cost of about $1 billion are being considered for calendar year 2011. Various coal conversion projects with costs between $600 million and $1 billion each are being considered. How this bill affects taxes on a particular project depends on whether it would be built without the incentives in this bill. If the project would be built without the incentives, this bill would reduce revenues below what they would have been without it. If the project would not be built without the incentives, this bill would increase revenues beyond what they would have been.
2. The following tables show the property taxes on a $1 billion electricity transmission project and a $1 billion coal conversion project under current law and under this bill.

Taxes from Hypothetical $1 Billion Transmission Project
($ million)

	Tax Rate	Taxable Value	State 95 mills	State 6 mills	Local 364 mills
Current Law - Class 9	12%	$120.00	$11.40	$0.72	$43.68
Class 15 & 50% Abatement	3%	$30.00	$1.43	$0.09	$5.46

Taxes From Hypothetical $1 Billion Coal Conversion Project
($ million)

	Tax Rate	Taxable Value	State 95 mills	State 6 mills	Local 364 mills
Current Law	3%	$30.00	$2.85	$0.18	$10.92
50% Abatement	3%	$30.00	$1.43	$0.09	$5.46

3. The following table shows the impacts of this bill on state and local property taxes if these projects *would not* be built without the incentives in this bill.

Revenue Impact if Projects Would Not Be Built Without Incentives
($ million)

	State 95 mills	State 6 mills	Local 364 mills
Transmission Project - Class 15 & Abatement	$1.43	$0.09	$5.46
Coal Conversion Project - 50% Abatement	$1.43	$0.09	$5.46

4. This table shows the impacts of this bill on state and local property taxes if these projects *would* be built without the incentives in this bill.

Revenue Impact if Projects Would Be Built Without Incentives ($ million)	State 95 mills	State 6 mills	Local 364 mills
Transmission Project - Class 15 & Abatement	($9.98)	($0.63)	($38.22)
Coal Conversion Project - 50% Abatement	($1.43)	($0.09)	($5.46)

Technical Notes:

1. Section 5 does not indicate what agency is to do the certification. Presumably it is the DEQ, but certifications under section 10 are to be done by the DOR.
2. Proposed law does not specify a measurable threshold percentage of carbon sequestered that a coal gasification facility or an integrated gasification combined cycle facility must exceed, in order for a contributing coal producer to be eligible for an exemption. Sections 5 and 6 do not provide any guidance for the agencies to use in establishing certification criteria in rules. Section 6 of the bill appears to give the DEQ some latitude in drafting rules necessary for certification and compliance relevant to the abatements granted in section 5. Proposed law would be stronger if the required percentage of carbon sequestered were specified in section 11.

Reduce Coal Severance Tax Rates– Department of Revenue

3. Administration of proposed law is difficult as written.
4. Proposed law does not clearly specify which agency will be responsible for ensuring that coal processing facilities meet the sequestration requirements, and that coal from Montana producers is actually used in these facilities. Future administrative expenditures to the DOR might be significant if extensive compliance efforts will be required to implement the bill.
5. The coal severance tax is paid quarterly. Proposed law would be easier to implement if the exemptions were defined within a quarterly frame of reference.
6. Subsection 11 (4)(a)(i) states that the first 20 years of production from a new mine will be partially exempt from tax "if at least 50% of the production of the coal produced by the mine" is used in conforming facilities.
   - "New mine" is not defined.
   - The meaning of "the production of the coal produced by the mine" is not clear.
7. Subsection 11 (4)(d)(ii) states:
   - "The exemptions under subsections 11 (4)(a)(i) and 11 (4)(a)(ii) continue for the full 20-year term if the number of tons of production necessary to qualify for the exemption in the first year does not decrease."

   The meaning of this statement is not clear. Difficulties include:
   - Exemptions are granted quarterly or annually, and refer to an exempt quantity of production. Is an exemption granted in the first quarter or year to continue for 20 years, referring in each succeeding instance to the same quantity of coal that was exempt in the first instance?
   - Does "number of tons of production" refer to the number of tons of production that are used by acceptable facilities, to the increase in production over an average of previous production, or to the total number of tons of production?
   - If the requirements in subsection 11 (4)(a)(i) and subsection 11 (4)(a)(ii) are satisfied in any given quarter, but the requirement in subsection 11 (4)(d)(ii) is not satisfied, will the coal producer qualify for an exemption in that quarter? If not, then why is this constraint neither specified nor referred to in subsection 11 (4)(a)(i) and subsection 11 (4)(a)(ii)?
8. How will a taxpayer know that coal they sold to a conforming facility is actually being used by that facility? For instance, a conforming facility might buy coal at a discount from a mine seeking an

exemption, and resell the coal at a profit to a non-conforming facility. How would the state monitor these transactions for audit purposes?

9. "Next fiscal quarter" in subsection 11 (4)(d)(i) is not defined.

Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*